

Internal Revenue Service

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Date:
May 22, 2014

TY:

Taxpayers =
Company =
Date =

Dear :

This letter responds to your request for a ruling under § 1202 of the Internal Revenue Code. In particular, you requested a ruling on whether the business of Company was a qualified trade or business as defined in § 1202(e)(3) notwithstanding the proximity of its business activities to the field of health.

FACTS

Taxpayers own stock in Company. Company provides products and services primarily in connection with the pharmaceutical industry. In particular, Company works with clients to help commercialize experimental drugs. Its business activities include research, development, manufacture and commercialization. More specifically, its activities under these broad headings include (1) research on drug formulation effectiveness; (2) pre-commercial testing procedures such as clinical testing; and (3) manufacturing of drugs. In addition, Company works with clients to solve problems in the pharmaceutical industry, such as developing successful drug manufacturing processes. To perform these tasks, Company uses its physical assets, such as its manufacturing and clinical facilities, as well as its intellectual property assets, including its patent portfolio. Company's successful performance of these activities in the past has earned the company several valuable relationships in the pharmaceutical industry.

Taxpayers disposed of some or all of their stock in Company on or about Date.

LAW

Section 1202 provides that gross income does not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

Section 1202(c)(2) provides that stock in a corporation is not treated as qualified small business stock unless the corporation meets the active business requirements of subsection (e).

Section 1202(e)(1) provides that a corporation meets the active business requirement of (c)(2) if at least 80 percent of the assets of the corporation are used by the corporation in the active conduct of one or more qualified trades or businesses.

Section 1202(e)(3) generally provides that a qualified trade or business means any trade or business other than a trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics, financial services, brokerage services, consulting, or any other trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. Section 1202(e)(3) further provides that the term qualified trade or business does not include businesses in which the principle activity involves providing services in the fields of finance, insurance, banking, investing, leasing, farming, mining, or running a hotel, motel, restaurant or similar businesses.

ANALYSIS

Section 1202(e)(3) excludes various service industries and specified non-service industries from the term “qualified trade or business.” Thus, a qualified trade or business cannot be primarily within service industries, such as restaurants or hotels or the providing of legal or medical services. In addition, § 1202(e)(3) excludes businesses where the principal asset of the business is the reputation or skill of one or more of its employees. This works to exclude, for example, consulting firms, law firms, and financial asset management firms. Thus, the thrust of § 1202(e)(3) is that businesses are not qualified trades or businesses if they offer value to customers primarily in the form of services, whether those services are the providing of hotel rooms, for example, or in the form of individual expertise (law firm partners).

Company is not in the business of offering service in the form of individual expertise. Instead, Company’s activities involve the deployment of specific manufacturing assets and intellectual property assets to create value for customers. Essentially, Company is a pharmaceutical industry analogue of a parts manufacturer in the automobile industry. Thus, although Company works primarily in the pharmaceutical industry, which is certainly a component of the health industry, Company does not perform services in the

health industry within the meaning of § 1202(e)(3). Neither are Company's business activities within any of the prohibited categories set forth in § 1202(e)(3).

RULING

Based on the facts submitted we rule that Company is engaged in a qualified trade or business under § 1202(e)(3) notwithstanding the proximity of its business activities to the field of health.

CAVEATS

Except as expressly provided, we do not express or imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we do not rule on whether Taxpayers meet other qualifications under § 1202, such as the holding period requirement or the asset usage requirement.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The taxpayer must attach a copy of this letter to any income tax return to which it is relevant. Alternatively, a taxpayer filing its returns electronically may satisfy this requirement by attaching a statement to the return that provides the date and control number of the letter ruling.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

J. Peter Baumgarten
Assistant to the Branch Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: